



Homeland
Security

August 6, 2004

MEMORANDUM FOR: John E. Pennington
Regional Director
FEMA Region X

Robert J. Lastrico

FROM: Robert J. Lastrico
Field Office Director

SUBJECT: *Audit of the City of Kelso, Washington*
Public Assistance Identification Number 015-35065
FEMA Disaster Number 1255-DR-WA
Audit Report Number DS-19-04

The Office of Inspector General (OIG) audited public assistance grant funds awarded to the City of Kelso, Washington (City). The objective of the audit was to determine whether the City expended and accounted for Federal Emergency Management Agency (FEMA) funds awarded for FEMA Disaster Number 1255-DR-WA according to federal regulations and FEMA guidelines.

The City received an award of \$5.2 million from the State of Washington Military Department's Emergency Management Division (EMD), a FEMA grantee, for emergency protective measures and alternate project funding for a residential acquisition program in lieu of permanent restorative work to damaged infrastructure. The disaster was declared as a result of excessive rains that resulted in landslide activity in the Aldercrest-Banyon subdivision of the City. The incident period began on March 6, 1998, and continued through November 19, 1998. The award provided 75 percent FEMA funding for nine large projects.¹ The audit covered the period from March 6, 1998, to January 7, 2003, and included a review of six large projects with a total award of \$4.6 million (see Exhibit).

The OIG performed the audit under the authority of the Inspector General Act of 1978, as amended, and according to *Government Auditing Standards* issued by the Comptroller General of the United States. The audit included a review of FEMA, EMD, and City records, a judgmental sample of project expenditures, and other auditing procedures considered necessary under the circumstances.

¹ Federal regulations in effect at the time of the disaster set the large project threshold at \$47,800.

BACKGROUND

The Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act) provides the means by which the federal government assists state and local governments in carrying out their responsibilities to alleviate the suffering and damage that result from disasters. Section 102 of the Stafford Act states that an “Emergency” means an occasion for which federal assistance is needed to supplement state and local efforts and capabilities to save lives and to protect property and public health and safety, or to lessen the threat of a catastrophe. Also, the Stafford Act states that a “Major Disaster” means any natural catastrophe that causes damage of sufficient severity and magnitude to warrant major disaster assistance under the Stafford Act to supplement the efforts and available resources of states and local governments.

Procedures for a Major Disaster Declaration. During the period of a major disaster event, the Governor of the affected state requests the President to declare a major disaster. The written request goes through the FEMA Regional Director (RD) of the affected state within 30 days of the occurrence of the incident. The RD reviews and forwards the request with a recommendation to the FEMA Director who then makes a recommendation to the President. The request includes the amount and nature of available state and local resources for the disaster, a damage estimate, impact on the community, estimate of the supplementary federal disaster assistance needed, and a certification of compliance with all applicable cost-sharing requirements of the Stafford Act. Based on the request, the President may declare the existence of a major disaster, and provide federal assistance to state and local governments. Among the types of assistance available are individual assistance, public assistance, and hazard mitigation. The public assistance program includes such costs as debris removal, emergency protective measures, and permanent repairs of public facilities.

The Public Assistance Process. Soon after the declaration, the state holds briefings and meetings in which applicants identify emergency needs and types of repair work they believe are eligible. Joint federal-state inspections are then scheduled. Local representatives show damaged sites to the inspectors and Damage Survey Reports (DSRs) are prepared to specify the scope of work and estimated costs.

Eligibility. Among the basic eligibility criteria for public assistance projects are requirements that the work must be a result of the declared event and that the work is the legal responsibility of an eligible applicant. FEMA may grant assistance for debris removal, emergency protective measures, and permanent restoration of public facilities. An alternate project option may be taken only on permanent restorative work.

Pertinent Declaration Information and Events. The following information and key events relate to the declaration of FEMA Disaster Number 1255-DR-WA for the City of Kelso.

- The Aldercrest-Banyon subdivision was developed from 1973 through 1978. During the disaster incident period, correspondence from the RD to FEMA Headquarters indicated there was evidence of instability before the land was developed but a geological survey had not been

performed at that time. The RD also stated the damaged infrastructure in the slide zone could not be permanently repaired or replaced.

- On June 17, 1998, the Governor requested the President to declare a major disaster for the City as a result of a landslide in the subdivision caused by rains over 3 consecutive years. The Governor requested funding through the Individual Assistance Program, the Hazard Mitigation Grant Program, and the Small Business Administration. The Governor noted that the information gathered during the joint federal-state preliminary damage assessment (PDA) did not warrant the need for funding under the Public Assistance Program, but may be required in the future.
- On July 29, 1998, a letter from three congresspersons to the President expressed their disappointment with the President's decision to deny the Governor's request for a major disaster declaration. Subsequently, an August 13, 1998 letter from the City Manager to the Small Business Administration acknowledged the denial by the President to grant the City a major disaster declaration.
- On August 21, 1998, the Governor appealed to the President to reconsider his denial to declare a major disaster as a result of the reactivation of the landslide in the City. The Governor asked for federal assistance under the Individual Assistance and Hazard Mitigation Grant Programs. On the same date, the Governor sent another letter through the RD requesting that the President declare a major disaster as a result of the reactivation of a prehistoric landslide that was caused by excessive rainfall during the past 3 years. This letter requested that federal assistance be provided under the Public Assistance and Hazard Mitigation Grant Programs.
- On August 27, 1998, in a memorandum to the FEMA Executive Associate Director, the RD recommended the Governor's appeal be denied for Individual Assistance and Hazard Mitigation Grant Programs. On the same date, in a separate memorandum to the FEMA Executive Associate Director, the RD recommended the Governor's request for a disaster declaration be denied for Public Assistance and Hazard Mitigation Grant Programs. Regarding public assistance funding, the RD stated, "If a declaration for Public Assistance is granted, other than for emergency measures, all projects will be 'alternative projects,' because nothing will be built or restored in the slide zone. Federal support for Emergency Measures would significantly help a small community recover from the additional costs of disaster response and recovery, and cushion the blow to the local economy. . . ." That memorandum also stated that the costs were within the state's capability, the damages were not caused by a clearly defined event as required for federal assistance under the Stafford Act, and the slide was pre-existing.
- On October 16, 1998, the President signed a major disaster declaration to provide Individual Assistance, Public Assistance, and Hazard Mitigation Assistance as a result of the landslide in the City. The declaration was made after a joint federal-state re-inspection of the area found that 88 homes had been affected with 32 destroyed. The initial inspection stated the landslide had impacted over 450 residents and 20 homes had been destroyed.

RESULTS OF AUDIT

The OIG questioned \$3,619,164 in costs claimed by the City for the six projects audited (FEMA's share is \$2,714,373). The costs questioned included \$3,499,231 for an ineligible alternate project election, and \$119,933 of other federal funds the City improperly applied to meet its cost-sharing requirement.

Finding A – The Alternate Project Election was Ineligible for FEMA Funding

While FEMA Region X categorized work on DSRs 61402, 61403, 61405, and 61406 as permanent work (Category C – Roads and Bridges and Category F – Utilities), the work was actually emergency work (Category B – Emergency Protective Measures) as defined by FEMA regulations. Because of this categorization, EMD and the City requested and received FEMA Region X approval for an alternate project to be used to partially fund the acquisition of residential properties in the slide area. According to FEMA regulations, an alternate project can be elected only as a substitute to permanent restorative work. As a result of FEMA's improper work categorization, the City claimed ineligible public assistance grant funding totaling \$3,499,231.

The classification of the above DSRs as permanent work was inconsistent with FEMA's classification of another similar project, DSR 61421, as emergency work. In approving DSR 61421 for a sanitary sewer system, FEMA review notes recognized that construction on the unstable land would need to be classified as emergency protective measures in order to be eligible, since permanent facilities could not be constructed in an area deemed to be unstable. This project replaced a temporary sewer system approved under DSRs 84039 and 26903, and had all the characteristics of permanent work with the exception that the construction was on unstable land. Therefore, FEMA classified the project as Category B – Emergency Protective Measures. DSRs 61402, 61403, 61405, and 61406 possessed similar attributes as DSR 61421, and therefore should have been classified as emergency work. The scopes of work included \$2,256,107 for the repair of damaged sections of the streets and utility systems, and \$1,243,124 to protect undamaged sections against future damages.

The damaged and undamaged sections of the work were consolidated at the time of the alternate project approval, as follows:

- As to the \$2,256,107 for damage repairs, the FEMA inspector concluded that the permanent repair of these damaged facilities was not feasible due to the current and expected future ground conditions. Further, a June 16, 1998 geotechnical report, prepared by the City's contractor, concluded that complete landslide stabilization was impractical and would not be cost effective.
- As to the \$1,243,124 for the undamaged street and utility sections, this work was originally written on other DSRs (61408, 61410, and 61411). The DSR scopes of work stated the work was required to prevent further damage that may occur in the next 5 years. This description is a defining quality of emergency work according to FEMA criteria but the DSRs were nevertheless categorized by FEMA as permanent work. Further, the work related to DSRs 61410 and 61411 (later consolidated with the damaged section funded by DSRs 61402 and 61403), was the subject

of a separate OIG audit performed by KPMG LLP (Audit Report DO-20-03 dated August 2003, *GRANT MANAGEMENT Washington's Compliance with Disaster Assistance Program's Requirements*). That audit reported the incorrect classification of the work as an "other matter" and recommended that the disaster be further reviewed. This OIG audit confirmed the incorrect work classification relative to DSRs 61410 and 61411 and disclosed that a similar condition existed for the undamaged section of work funded by DSR 61408 (later consolidated with the damaged section funded by DSR 61406).

As described above, the section of the work to repair damages could only be eligible as emergency work, since permanent repairs of facilities are not eligible on unstable land. In addition, the work related to the undamaged sections was intended to prevent damage that may occur in the next 5 years, a defining quality of emergency work. Nonetheless, FEMA incorrectly classified the projects as permanent and approved an alternate project under the Public Assistance Program to partially fund the acquisition of residential properties in the slide area. Along with the public assistance funding, FEMA also approved additional funding for the acquisition under the Hazard Mitigation Grant Program and the Unmet Needs Program.

FEMA criteria applicable to the award of public assistance funding to the City is discussed below:

- Title 44, Code of Federal Regulations, Section 206.223(a) [44 CFR § 206.223(a)] provides that to be eligible under the Public Assistance Program, work must be required as the result of the major disaster event and must be the legal responsibility of an eligible applicant. Further, FEMA's Public Assistance Guide (FEMA 286), Page 63 provides that permanent repairs to a facility are eligible as long as the site is stable. It also states that emergency work can be provided if there is an immediate threat to life, public health, and safety. While the permanent repairs to critical infrastructure (e.g., streets and utility systems) were the legal responsibility of the City, those repairs were deemed impractical and not cost effective due to the instability of the slide area. Therefore, only emergency work to save lives and protect property was eligible for public assistance funding.
- Subsection 406(c)(1) of the Stafford Act states that when the public interest would not be best served by repairing, restoring, reconstructing, or replacing any public facility, the state or local government may elect to receive alternate project funding. Funds contributed under this subsection may be used to repair, restore, or expand other selected facilities, to construct new facilities, or to fund hazard mitigation measures determined to be necessary to meet a need for governmental services and functions in the areas affected by the major disaster. In the case of the Aldercrest-Banyon subdivision, there were no other facilities that could be repaired, restored, expanded, or constructed because of the emergency nature of the work and the instability of the slide area, and the residential acquisition program as a mitigation measure did not meet a need for governmental services and functions in the areas affected by the major disaster.
- 44 CFR § 206.203(d)(2) states that in any case where a subgrantee determines that the public welfare would not be best served by restoring a damaged public facility or the function of that facility, the grantee may request that the RD approve an alternate project. Subsection (i) states,

“The alternate project option may be taken only on permanent restorative work.” While the public welfare would not be best served by restoring damaged roads and utilities in the Aldercrest-Banyon subdivision, implicit in the regulations is that permanent restorative work could have been accomplished in the first place. As indicated above, DSRs 61402, 61403, 61405, and 61406 could not provide funding for permanent restorative work. The scopes of work for those DSRs possessed all the attributes of emergency work given the instability of the site. Therefore, alternate project funding to partially fund the acquisition of residential properties was not a viable funding alternative since “permanent restorative work” could not have been accomplished.

- 44 CFR § 206.225(a)(3)(ii) states that emergency protective measures must lessen immediate threats of significant additional damage to improved property. Section 206.221(c) defines “immediate threat” as the threat of additional damage or destruction from an event that can reasonably be expected to occur within 5 years. In funding construction of a sanitary sewer system as emergency work,² FEMA recognized that permanent restorative work could not be accomplished in the Aldercrest-Banyon subdivision. Contrarily, FEMA categorized other emergency work as permanent even though the slide area remained unstable.

The City relied upon FEMA’s classification of these projects as permanent, and did not consider that they should question FEMA’s determinations in their request for alternate project funding. Nonetheless, regulations, when properly promulgated and within the bounds of the agency’s statutory authority, have the force and effect of law and may not be waived on a retroactive or ad-hoc basis.³ Further, grant funds erroneously awarded must be recovered by the agency responsible for the error, including expenditures the grantee incurred before receiving notice that the agency’s initial determination had been made in error.⁴ In addition, an erroneous agency determination that an applicant was eligible for grant assistance may not be used as the justification for not requiring repayment of the monies in question.⁵ Therefore, the OIG is questioning \$3,499,231 in alternate project funding provided to the City.

Finding B – The City Improperly Met Its Cost-Sharing Requirement with Other Federal Funds

The City claimed \$119,933 under DSR project 61404 for demolition costs that were ineligible due to the funding provided by another federal program. Contrary to FEMA rules for public assistance grant funding, the City used funds from another federal agency to meet its local cost-share of \$119,933 for this project. Since by regulation federal funds from another agency cannot be used to meet the cost-share, those funds effectively duplicated a portion of the FEMA share of funding, resulting in an overpayment by FEMA of \$119,933.

² The sewer system was required to meet the needs of homeowners who chose not to leave the slide area.

³ 2 GAO, Principles of Federal Appropriations Law (GAO/OGC 92-13) 10-25 (1992) (citing 57 Comp. Gen. 662 (1978) with respect to eligibility standards).

⁴ 51 Comp. Gen. 162 (1971).

⁵ 51 Comp. Gen. 162, 165 (1971)

The FEMA-State Agreement provided that “Any Federal funds provided under the Stafford Act for Public Assistance will be limited to 75 percent of total eligible costs in the designated area.” The state agreed to pay 12.5 percent of the eligible costs, leaving a remainder of 12.5 percent for the City to fund. Under 44 CFR § 13.24(b), a cost-sharing requirement may not be met by costs borne by another federal grant.

The City received a \$500,000 obligation through the Community Development Block Grant (CDBG) program (CDBG Contract Number F-99-64099-031) from the U.S. Housing and Urban Development’s (HUD) Slums and Blight National Objective. The City applied \$162,380 to fund work related to the demolition project that was ineligible for FEMA funding, and applied an additional \$119,933 to fund the City’s local share of the FEMA eligible costs (\$959,461 times 12.5%). On June 5, 2002, the State of Washington Office of Community Development advised the City that their CDBG project had been completed, \$217,687 remaining in the account would be de-obligated, and the contract would be closed.

The CDBG funding resulted in total federal payments of \$839,529 (\$719,596 FEMA plus \$119,933 CDBG) or 87.5 percent for this project. Pursuant to 44 CFR § 13.24(b), none of these federal payments can be applied to the 25 percent non-federal share. Therefore, the OIG questions the federal overpayment of \$119,933 of the 75 percent federal portion of the funding and in addition, the non-federal share of the adjusted eligible costs for this project [(\$959,461 less \$119,933) times 25%] is required to be funded with non-federal sources.

OTHER MATTERS

Non-compliance with Alternate Project Terms

Although the OIG concluded that the alternate project election was not available due to the emergency status of the projects replaced, the audit disclosed that the City did not meet the terms of the alternate project funding of \$3,499,231. These terms included a requirement that the slide area be converted to open space with no structures or facilities in the area. This would allow the area to revert to natural wilderness. This requirement is explicitly stated in 44 CFR § 206.434(d)(1)(ii), as well as in the acquisition agreements with the homeowners. FEMA approved an emergency protective measure to construct a sanitary sewer system under DSR 61421 for the homeowners remaining in the Aldercrest-Banyon subdivision and thus, allowed the City to non-comply with the acquisition agreements with the homeowners. If the alternate project election had been a viable funding option for the residential acquisition program, the OIG would have questioned alternate project costs of \$3,499,231 on the basis that acquisition terms were not met due to the subsequent construction of the sewer system.

Duplication of Funding

The claim for \$141,429 under DSR 61421 was duplicative of costs claimed under DSR 61405. DSR 61421 was for construction of a sanitary sewer system for the remaining residents in the slide area who chose not to participate in the home acquisition project, whereas DSR 61405 was for

construction of a sanitary sewer system to serve all of the residents in the slide area absent the home acquisitions. DSR 61405 was one of the four projects substituted by the alternate project. However, if this project had been performed, there would have been no need for the scaled-down version of the sewer system as approved in DSR 61421. Since the audit questioned all costs for DSR 61405 as a part of Finding A, no additional questioned costs will result from this finding.

Cost-Sharing

The City did not meet the cost-sharing requirement of \$437,404 for the alternate project approved under DSRs 61402, 61403, 61405, and 61406. The City and EMD agreed to a 12.5 percent split of the 25 percent local share of the FEMA-funded projects. In meeting their 12.5 percent share for the alternate project, the City considered the homeowner's lost equity as the local share. However, due to the slide conditions, these homes were not marketable. Therefore, the City's use of the homeowner's lost equity as their cost sharing contribution is not in compliance with FEMA regulations as provided in 44 CFR § 13.24. Since the FEMA funding for these projects was questioned in total under Finding A, the non-compliance with the cost-sharing requirement will not result in additional questioned costs.

RECOMMENDATIONS

The Office of Inspector General recommends that the Regional Director, FEMA Region X, in coordination with the EMD:

1. Disallow \$3,619,164 in questionable costs under the public assistance grant.
2. Review funding under the Hazard Mitigation Grant and the Unmet Needs Programs and make any required deductions as a result of the ineligible public assistance funding.
3. Ensure that the City's cost-sharing contribution of eligible public assistance grants be funded from eligible sources.
4. Review the issues reported under the "Other Matters" section and respond as to any actions taken.

DISCUSSIONS WITH MANAGEMENT AND AUDIT FOLLOW UP

The OIG discussed the results of this audit with FEMA Region X, EMD, and City officials on June 23, 2004. Those officials generally disagreed with the findings and recommendations.

- For Finding A, EMD and City officials explained that the issues surrounding the project were discussed with high level government officials who concluded the project met the funding requirements under the Public Assistance Program. For Finding B, these officials agreed that CDBG funds were used to meet the City's matching requirements under the FEMA grant and that HUD rules allow the use of the funds for such purposes. They expressed concern as to the

lack of uniformity and inconsistencies among federal grant requirements. Subsequent to the June 23, 2004 meeting, EMD and City officials provided the OIG with additional documentation supporting their position. The OIG's review of these documents did not identify information that would serve as a basis for changing the findings and conclusions.

- For the issues identified as "Other Matters", EMD noted that there was no duplication of funding affecting DSRs 61421 and 61405. The OIG re-evaluated funding documents supporting this issue and again determined that costs for constructing a sanitary sewer system were included in both DSRs. Officials did not provide arguments for the issues pertaining to "Non-compliance with Alternate Project Terms" and "Cost-Sharing".

Please advise this office by October 6, 2004, of the actions taken to implement the recommendations in this report. Should you have any questions concerning this report, please contact me at (510) 627-7011. Key contributors to this assignment were Humberto Melara, Jack Lankford, Paulette Solomon, and Jeff Flynn.

Schedule of Audited Projects
City of Kelso, Washington
Public Assistance Identification Number 015-35065
FEMA Disaster Number 1255-DR-WA

<u>Project Number</u>	<u>Amount Awarded</u>	<u>Questioned Costs</u>	<u>Finding Reference</u>
61402	\$1,627,414	\$1,627,414	A
61403	426,454	426,454	A
61404	959,461	119,933	B
61405	248,290	248,290	A
61406	1,197,073	1,197,073	A
61421	141,429	0	
Totals	<u>\$4,600,121</u>	<u>\$3,619,164</u>	

Finding Reference Legend:

- A. The Alternate Project Election was Ineligible for FEMA Funding
- B. The City Improperly Met Its Cost-Sharing Requirement with Other Federal Funds